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No. 09-447

IN THE
Supreme Court of the United States

DENNIS HECKER, JONNA DUANE, AND JANICE RIGGINS,
Petitioners,

v.

DEERE & COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF FOR PETITIONERS

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In departing from other circuits' law and Department of Labor ("DOL") settled policy, the Seventh Circuit held that pension plan participants cannot state a claim under ERISA for imprudent selection of retail mutual funds with unnecessarily high fees if the selected retail mutual funds have "a wide range of expense ratios." Pet. App. 19a. That holding functionally negates any obligation by pension plan administrators to select lower-cost investment options, and thus authorizes an enormous transfer of wealth from American workers to mutual fund investment advisers.

Deere offers no persuasive reasons for denying certiorari. Deere's contention that petitioners "waived" their challenge to the prudence of Deere's selection of retail Fidelity mutual funds is wholly unsupported. Petitioners included that challenge in their Second Amended Complaint ("Amended Complaint"), and they pressed it below. Moreover, the Seventh Circuit rejected petitioners' challenge on the merits, which alone defeats Deere's waiver argument.

Deere's remaining arguments also are unavailing. The Seventh Circuit's holdings under § 404(a) and § 404(c) of ERISA are at odds with other circuits' decisions and DOL's authoritative interpretation. After the certiorari petition was filed, the Eighth Circuit reversed a district court's dismissal of claims virtually indistinguishable from those pressed by petitioners below. Deere barely references that Eighth Circuit decision and ignores its import. Instead, Deere seeks to defend the Seventh Circuit's holdings below on the merits without persuasively addressing the conflicts that now exist on both questions presented.

The circuit conflict created by the decision below generates massive uncertainty for American pension plan participants and their employers. Whether a participant can state a claim for a breach of fiduciary duty under ERISA for a company's inclusion of retail mutual funds in 401(k) plans now rests entirely on the fortuity of where employees work and where their companies are based. Each year, plan administrators invest pension plan assets in high-cost retail mutual funds that drain American workers' retirement assets of hundreds of millions of dollars in unnecessary and excessive fees. Given those enormous costs, the Court should review the important and recurring issues raised by the petition.

I. PETITIONERS HAVE NOT WAIVED THEIR CHALLENGE TO DEERE'S IMPRUDENT SELECTION OF RETAIL MUTUAL FUNDS WITH EXCESSIVE FEES

Deere contends that petitioners "waived" any challenge to its imprudent selection of retail mutual funds with unnecessarily high fees because petitioners "limited their prudence challenge" to Fidelity's revenue-sharing arrangement until their petition for rehearing in the Seventh Circuit. Opp. 12, 17-18. The record does not support those contentions.

Petitioners' Amended Complaint alleged that Deere's failure to minimize the costs of investment options constituted a breach of Deere's fiduciary obligations under ERISA. That allegation encompassed petitioners' claim that Deere's selection of retail Fidelity mutual funds (and their attendant high fees) was inappropriate given the availability of alternative investment vehicles with significantly lower fees. *See* Am. Compl. ¶¶ 36, 44, 76, 105(a), (b), (c), (f), (j); *see also* DOL Rehearing Br. 3 (noting that Deere's

selection of excessive, retail-level fees was at the heart of the Amended Complaint).

The district court squarely addressed petitioners' excessive-fees claim. As that court recognized, in addition to the challenge to the revenue-sharing arrangement, "[t]he second amended complaint also allege[d] that defendants breached their fiduciary obligations by selecting and offering investment options with unreasonably high fees for the 401(k) plans." Pet. App. 42a. Specifically, "[petitioners] allege[d] that defendants breached their fiduciary duties . . . by failing to properly evaluate the expense ratios applicable to the plan investment options and provide less expensive options so participants paid greater expenses than necessary, resulting in investment losses." *Id.* at 46a. The court dismissed petitioners' claim on the ground that the § 404(c) safe harbor barred liability. *See id.* at 46a-47a.

On appeal, petitioners again contended that Deere's selection of high-cost retail mutual funds was imprudent. The Seventh Circuit likewise addressed that as a separate claim distinct from the failure to disclose Fidelity's revenue-sharing arrangement. *See id.* at 16a ("distill[ing]" the Amended Complaint into two assertions: (1) Deere failed to disclose the revenue-sharing agreement and (2) "Deere imprudently agreed to limit the investment options to Fidelity Research funds and therefore offered only investment options with excessively high fees"); *see also id.* at 19a (addressing "plaintiffs' contention that Deere violated its fiduciary duty by selecting investment options with excessive fees"). The Seventh Circuit upheld the district court's dismissal, ruling that petitioners' allegations failed to state a claim under § 404(a)

and, alternatively, that defendants were immune from liability under § 404(c)'s safe harbor.

In its supplemental order denying rehearing, the Seventh Circuit reaffirmed its rejection of petitioners' challenge to Deere's selection of high-cost retail mutual funds:

> [Plaintiffs] *argued* . . . that the Plans were flawed because Deere decided to accept "retail" fees and did not negotiate presumptively lower "wholesale" fees. The opinion discusses a number of reasons why that particular assertion is not enough, in the context of these Plans, to state a claim, and we adhere to that discussion.

Id. at 53a (emphasis added).

In sum, petitioners challenged Deere's selection of unnecessarily costly investment options throughout the proceedings below. Moreover, the Seventh Circuit decided the issue, which alone makes it appropriate for this Court's review. *See, e.g., United States v. Williams*, 504 U.S. 36, 41 (1992) (Court may review an issue not pressed so long as it has been passed upon by the court below). Deere's waiver argument, therefore, is baseless.

II. THE SEVENTH CIRCUIT'S IMPROPERLY NARROW INTERPRETATION OF § 404(a) WARRANTS THIS COURT'S REVIEW

In its opposition, Deere nowhere even mentions that the Eighth Circuit recently reversed a district court's dismissal under Rule 12(b)(6) of claims virtually indistinguishable from those in petitioners' Amended Complaint, in clear conflict with the decision below. Deere's emphasis on the merits provides no basis for denying certiorari to resolve the conflict that exists.

A. The Eighth Circuit's Recent Decision In *Braden v. Wal-Mart* Directly Conflicts With The Decision Below

The decision below cannot be squared with long-standing circuit precedents holding that a fiduciary's decision should be judged based not only on its results but also on "whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment." Pet. 24 (internal quotations omitted). Since the filing of the petition, the Eighth Circuit has rejected the contrary approach taken by the Seventh Circuit below.

In *Braden v. Wal-Mart Stores, Inc.*, No. 08-3798, 2009 WL 4062105 (Nov. 25, 2009), the Eighth Circuit held that allegations of imprudent investment selection nearly identical to those in this case were sufficient to state a claim under § 404(a). Like petitioners, the plaintiff (Braden) alleged that Wal-Mart, given its large pension plan, breached its fiduciary duty to plan participants by "offer[ing] only retail class shares, which charge significantly higher fees than institutional shares for the same return on investment." *Id.* at *7; *see also id.* at *1-*2 (describing plaintiff's challenge to the selection of retail mutual funds). The Secretary of Labor filed an *amicus* brief supporting the plaintiff, as she did in this case, on the ground that a plan administrator's failure to "conduct[] an adequate investigation of available fund options, fees and performance," and "to use the [Plan's] considerable bargaining power . . . to negotiate better fees for the Plan," constituted a breach of fiduciary duty under § 404(a). DOL *Braden* Br. 4. Wal-Mart, citing *Hecker*, argued that those allegations failed to state a claim for fiduciary breach because the selected retail mutual funds' expense ratios

were "'set against the backdrop of market competition.'" Appellees *Braden* Br. 22-25 (Apr. 7, 2009) (quoting *Hecker*).

In direct conflict with the Seventh Circuit, the Eighth Circuit agreed with the plaintiff and the DOL, holding that the allegations of the *Braden* complaint, if proved, would state a claim for fiduciary breach. *See* 2009 WL 4062105, at *8. The decision below squarely conflicts with the Eighth Circuit's decision in *Braden*, as even the employer in that case (Wal-Mart) recognizes.[1] Deere's brief in opposition hardly mentions *Braden*,[2] and all it can muster is a weak attempt at distinguishing *Braden* on the ground that Wal-Mart offered a relatively small number of high-cost retail mutual funds, whereas Deere here offered numerous high-cost mutual fund options to plan participants. *See* Opp. 16. But the number of available retail funds cannot be dispositive given that petitioners and the *Braden* plaintiff challenged the plan administrator's failure to consider alternative investment vehicles that have systematically lower expense ratios than retail mutual funds. The

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[1] In its rehearing *en banc* petition in *Braden*, Wal-Mart states that "[t]he Panel's ruling . . . directly conflicts with the Seventh Circuit's decision in *Hecker*." Appellees *Braden* Reh'g Pet. 11 (Dec. 9, 2009); *see also id.* at 12 ("[n]or is *Hecker* distinguishable").

[2] Deere cites *Braden* for the proposition that a "'bare allegation that cheaper alternative investments exist in the marketplace'" is insufficient to plead a breach of fiduciary duty under § 404(a), 2009 WL 4062105, at *8 n.7 (quoting *Hecker*), but petitioners' Amended Complaint rested on no such "bare allegation," *see* Pet. 26 n.8. Rather, as in *Braden*, petitioners allege that Deere failed to conduct an adequate investigation into lower-cost options and chose retail mutual funds because they paid costs that Deere otherwise would have borne. Pet. 26-27.

holding in *Braden* – that a plan administrator's failure to compare the cost of retail funds versus cheaper alternatives states a claim for imprudence under § 404(a) – conflicts with *Hecker*. This Court should review the decision below because it creates a circuit conflict on the scope of a plan administrator's fiduciary duty to investigate lower-cost available investment options. *See also In re Honda of Am. Mfg., Inc. ERISA Fees Litig.*, No. 2:08-cv-1059, 2009 WL 3270490 (S.D. Ohio Oct. 9, 2009) (dismissing complaint challenging inclusion of retail mutual funds based on *Hecker* and the now-overruled district court decision in *Braden*).

B. Deere's Remaining Arguments Confirm The Need For This Court's Review

Deere's remaining arguments on the merits highlight the need for this Court's review. Deere notes (at 18) that 91% of 401(k) plans offer retail mutual funds and 55% of all 401(k) plan assets (more than $1.7 trillion) are invested in such funds. Those statistics underscore the critical importance of the questions presented to American workers. The additional fees associated with high-cost retail mutual funds diminish American pension plan assets by more than a billion dollars annually. *See* Pet. 30; AARP *et al.* Br. 8-10. Given those economic stakes, this Court's review is urgently needed.

Deere, moreover, defends the decision below on the ground that ERISA incorporates industry norms into the fiduciary standards under § 404(a), such that the selection of high-cost retail mutual funds is, as a matter of law, consistent with plan administrators'

fiduciary duties.[3] Not only does that argument have no basis in ERISA, but, apart from unspecified "reasons for this" industry practice (Opp. 19), Deere offers no justification for the additional costs of selecting higher-priced retail mutual funds. Petitioners allege that Deere selected Fidelity's retail mutual funds because it failed to conduct an adequate investigation and because it sought to benefit itself at the expense of the plans' participants. Dismissal of those allegations at the pleading stage without any opportunity for factual development on the basis of an unexplained industry practice creates an enormous loophole in ERISA's fiduciary protections for American pension plan participants that warrants this Court's review.[4]

Finally, invoking the "hypothetical prudent fiduciary" doctrine, Deere argues that "the court of appeals correctly concluded that petitioners were not injured because they could choose from a variety of investment options with varying costs." Opp. 22-23. But that argument simply begs the question presented: whether Deere's selection of retail mutual funds was objectively reasonable given the availa-

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[3] Deere seeks to deflect attention from its own breach of fiduciary duty by mischaracterizing (at 36) petitioners' argument as advocating a *per se* rule "outlaw[ing]" inclusion of retail mutual funds under any circumstances. Petitioners have never made any such argument. But plan administrators, such as Deere, should not receive blanket immunity from liability under § 404(a) of ERISA simply because they *include* a wide range of retail mutual funds. Each case should be judged on its own facts.

[4] Deere suggests (at 17) that plan participants received various investment management services in exchange for the higher fees. As Deere acknowledges (at 19), however, the record contains no evidence of any such services, and thus provides no justification for dismissing petitioners' claims.

bility of other, lower-cost options. *See Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 919 (8th Cir. 1994) (stating that the "hypothetical prudent fiduciary" doctrine asks whether the fiduciary's decisions were objectively reasonable). The Eighth Circuit in *Braden* concluded that the substantive allegations at issue here stated a claim for fiduciary breach. The conflict between the Seventh and Eighth Circuits warrants this Court's review given the importance of the question to American workers.

III. THE SEVENTH CIRCUIT'S INTERPRETATION OF § 404(c) MERITS REVIEW

A. The Conflict With The Fourth Circuit Is Significant

The Seventh Circuit's holding that the Secretary's interpretation of § 404(c) in the preamble to her regulations was not entitled to *Chevron* deference cannot be squared with the contrary conclusion of the Fourth Circuit in *DiFelice*. *See* 497 F.3d at 418 n.3; Pet. 15-18. The decision below thus deepened a pre-existing division between the Fourth and Fifth Circuits regarding the legal force of the Secretary's preamble and the proper interpretation of § 404(c).

Deere suggests (at 29) that the circuit split is "illusory" because the Fourth Circuit's discussion of § 404(c) in *DiFelice* was technically dictum. As explained in the petition (at 16-17), however, many district courts have agreed with *DiFelice* and the dissent in *Langbecker* that the Secretary's preamble merits deference. By contrast, the Seventh Circuit expressly rejected *DiFelice*, *see* Pet. 11-12, as have all district court decisions within that circuit since *Hecker*, *see* Pet. 17-18. As this Court has long recognized, influential dicta can have far-reaching consequences and often are appropriate for review. *See*,

e.g., *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 536 (1994) (granting certiorari to review "dicta" that had been the source of disagreement among numerous lower courts). Given the pervasive division among the lower courts on an important question concerning the Secretary of Labor's regulatory scheme, this Court's review is warranted.

Deere also argues (at 30) that the Seventh Circuit's ruling under § 404(c) does not justify certiorari because it was an "alternative" holding. However, the only other basis for the Seventh Circuit's decision – namely, its narrow interpretation of § 404(a) – also warrants review because it, too, conflicts with the law of other circuits and the position of the DOL. The Court should grant certiorari to review both of the Seventh Circuit's alternative holdings.

B. Deere's Merits Arguments Confirm The Need For This Court's Review

Deere's brief does not defend the Seventh Circuit's rationale that the Secretary's regulatory preamble does not deserve deference because it was not codified "in the regulation proper." Pet. App. 50a. That implicit confession of error is dictated by this Court's decisions, which require courts to defer to administrative interpretations that reflect the agency's "fair and considered judgment" on the matter. *See*, *e.g.*, *Auer v. Robbins*, 519 U.S. 452, 462 (1997); *see also* Pet. 20-22. Here, the interpretation in question went through full notice-and-comment rulemaking and thus far exceeded that standard. *See* Pet. 18-20.

Deere now contends that, under *Chevron* and *Auer*, the Secretary's interpretation exceeds her regulatory authority under § 404(c), which Deere says (at 32-33) is confined to interpreting when a plan participant has control "over the assets in his account." First,

§ 505 of ERISA gives the Secretary authority to "prescribe such regulations as [s]he finds necessary or appropriate to carry out the provisions of this subchapter." 29 U.S.C. § 1135; *see Massachusetts v. Morash*, 490 U.S. 107, 117-18 (1989). The Secretary's interpretation clearly falls within that plenary authority.

Moreover, § 404(c) is ambiguous because it does not define when a loss "results from [a] participant's or beneficiary's exercise of control [over the assets in his account]." As Deere itself acknowledges (at 32), plan participants do not exercise control over investment selection. Accordingly, the Secretary reasonably construes the safe harbor not to apply when losses result from the plan fiduciary's imprudent selection of the plan's menu of investment options. If the Court does not grant certiorari to resolve the lower courts' disagreement, it should at least request the Solicitor General's views on how the Seventh Circuit's judgment affects the Secretary's regulatory regime.

IV. THE QUESTIONS PRESENTED INVOLVE CRITICAL ISSUES FOR EMPLOYEE RETIREMENT PLANS

As Deere acknowledges, the widespread practice of investing plan assets in high-cost retail mutual funds has enormous economic implications for American workers and companies. Unsurprisingly, extensive litigation is being waged in the lower courts over excessive fees. *See* Opp. 13-14. The decision below has become a focal point of that litigation. While Deere argues that *Hecker*'s holding was limited to the Amended Complaint, defendants have urged courts to read *Hecker* for the broad proposition that defendants can never be held liable for excessive fees as

long as they offer a "wide range of investments and expense ratios . . . to participants." Defendants-Appellees Br. 25-26, *Taylor v. United Techs. Corp.*, No. 09-1343-cv (2d Cir. filed July 27, 2009); *see also Loomis v. Exelon Corp.*, No. 06-cv-4900, 2009 WL 4667092 (N.D. Ill. Dec. 9, 2009) (holding that, under *Hecker*, plans offering a sufficient mix of investment options do not breach *any* fiduciary duty); *Honda*, *supra* (dismissing challenge to inclusion of retail funds based on *Hecker*). Indeed, defendants have called *Hecker*'s holding a "fundamental shift" in ERISA jurisprudence. Mem. in Support of Defs.' Mot. for J. on the Pleadings 2, *Martin v. Caterpillar, Inc.*, No. 07-1009 JBM/JAG (C.D. Ill. filed Feb. 19, 2009). Because of that "shift," employers in the Seventh and Eighth Circuits are now subject to different fiduciary obligations. Given the prevalence of excessive-fee litigation, the divisions in the lower courts will only deepen and prompt needless litigation until this Court reviews these issues.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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